

REPORT OF EXAMINATION  
OF THE  
21st CENTURY CASUALTY COMPANY  
AS OF  
DECEMBER 31, 2005

Participating State  
and Zone:

California

Filed June 7, 2007

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Los Angeles, California  
April 12, 2007

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition (EX4) Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Kent Michie  
Secretary, Zone IV-Western  
Commissioner of Insurance  
Department of Insurance, State of Utah  
Salt Lake City, Utah

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

21st CENTURY CASUALTY COMPANY

(hereinafter also referred to as the Company) at the statutory home office and primary location of its books and records, 6301 Owensmouth Avenue, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination was conducted concurrently with an affiliate and included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; loss experience; growth of company; business in force by states; and sales and advertising.

### SUBSEQUENT EVENTS

On January 25, 2007 a press release indicated American International Group (AIG) had submitted an unsolicited proposal to the board of directors of 21st Century Insurance Group (Parent) to acquire the remaining shares of the Parent's common stock that AIG and its subsidiaries do not already own for \$19.75 per share in cash.

The Parent's board of directors formed a special committee comprised entirely of independent and outside directors for the purpose of considering the proposal from AIG.

On May 15, 2007 a press release indicated that the Parent and AIG had entered into a definitive merger agreement providing for the acquisition by AIG of all of the outstanding shares of common stock of the Parent not currently owned by AIG for \$22.00 per share in cash. Upon completion of the transaction, the Parent will become a wholly owned subsidiary of AIG. The acquisition is subject to customary conditions and approvals.

### COMPANY HISTORY

The Company was incorporated in California on September 8, 1987 for the purpose of conducting property and casualty insurance business and commenced business on January 4, 1988.

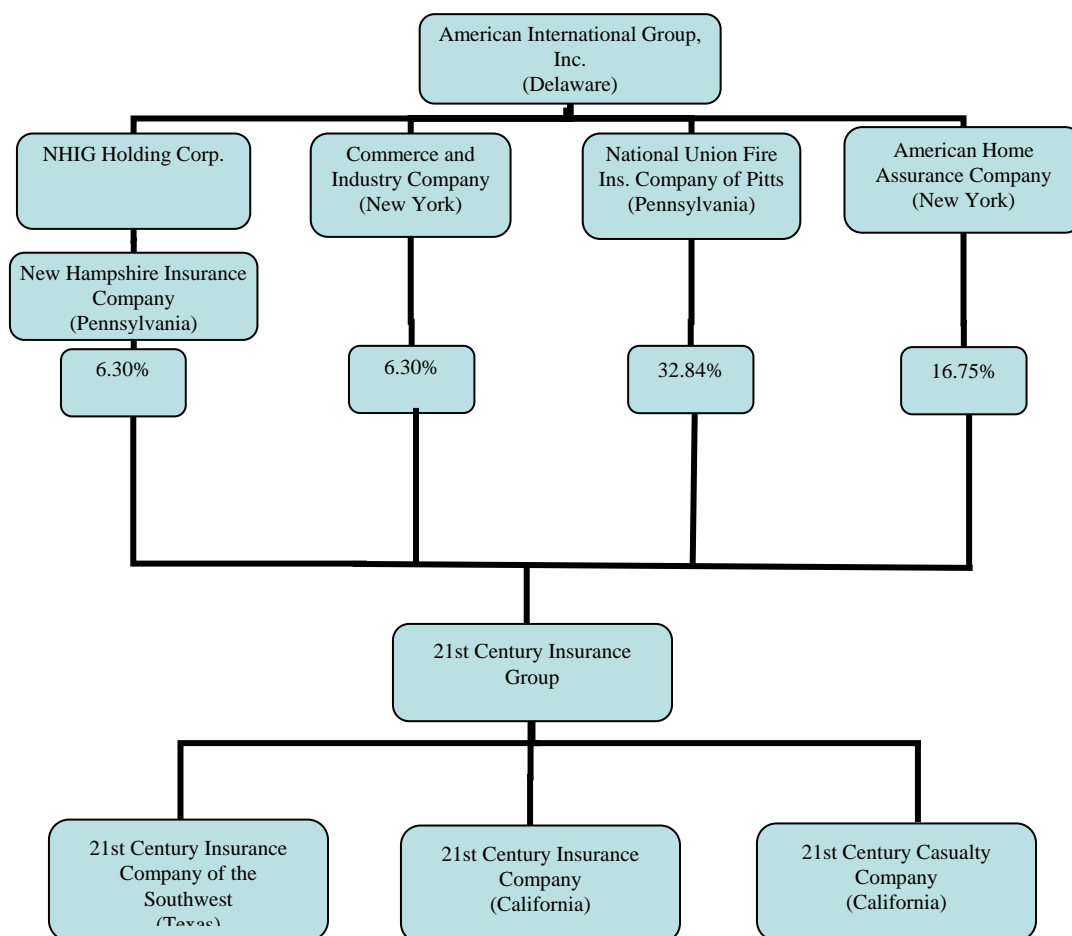
Effective January 24, 2000, the Company and its parent changed their names from 20th Century Casualty Company to 21st Century Casualty Company and from 20th Century Industries to 21st Century Insurance Group (Parent), respectively. Effective December 4, 2003, the Parent was

reincorporated under the laws of Delaware. Through several of its subsidiaries, American International Group (AIG) currently owns approximately 62% of the Parent's outstanding common stock.

### MANAGEMENT AND CONTROL

The Company is a wholly-owned insurance subsidiary of the 21st Century Insurance Group (Parent), an insurance holding incorporated in Delaware.

The following organizational chart depicts the Company's relationship within the holding company system:



(\*) all ownership is 100% unless otherwise noted

Management of the Company is vested in an eleven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2005 follows:

### Directors

#### Name and Residence

Robert M. Sandler  
New York, New York

#### Principal Business Affiliation

Chairman of the Board  
21st Century Insurance Group  
Executive Vice President  
American International Group, Inc.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Bruce W. Marlow Los Angeles, California	Vice Chairman of the Board, Chief Executive Officer, and President 21st Century Insurance Group
Steven J. Bensinger New York, New York	Executive Vice President, Chief Financial Officer, Treasurer and Comptroller American International Group, Inc.
John B. De Nault, III Orange, California	Self Employed
Carlene M. Ellis El Dorado, California	Intel Corporation (Retired)
R. Scott Foster, M.D. Stockton, California	Private Practice
Roxani M. Gillespie San Francisco, California	Barger & Wolen, LLP
Jeffrey L. Hayman Tokyo, Japan	Chairman, AIU Insurance Company – Japan Regional President and Chief Operating Officer, General Insurance AIG Companies Far East
Phillip L. Isenberg Sacramento, California	President, Isenberg/O'Haren
James P. Miscoll (*) San Rafael, California	Bank of America (Retired)
Keith W. Renken Arcadia, California	Director, East West Bank Adjunct Professor, University of Southern California

(\*) Resigned January 20, 2006, replaced by Thomas R. Tizzio

### Principal Officers

<u>Name</u>	<u>Title</u>
Bruce W. Marlow	President and Chief Executive Officer
Lawrence P. Bascom (*)	Senior Vice President, Chief Financial Officer and Treasurer
Michael J. Cassanego	Senior Vice President, General Counsel and Secretary
Richard A. Andre	Senior Vice President, Human Resources
Dean E. Stark	Senior Vice President, Claims
Michael T. Ray	Senior Vice President, Customer Processes
John L. Ingersoll (**)	Vice President, Current Customer and New Customer Marketing
Marlis S. Kerby	Vice President, Information Technology
Allen Lew	Vice President and Chief Actuary
John M. Lorentz	Vice President, Finance
Caren L. Silvestri	Vice President and Product Manager

(\*) Employment terminated, effective April 7, 2006, replaced by Steven P. Erwin

(\*\*) Employment terminated, effective October 9, 2006

### Management Agreements

Services Agreement: Effective December 31, 2002, the Company entered into a services agreement with its affiliated company, 21st Century Insurance Company (21st), whereby 21st furnishes administrative and facilities services to the Company to carry on its business. The Company reimburses 21st for its actual cost incurred in providing the services. The agreement was approved by the California Department of Insurance (CDI) on October 23, 2002.

Tax Sharing Agreement: Effective December 31, 2002, the Company and its affiliates entered into a consolidated federal income tax agreement with its parent, 21st Century Insurance Group (Parent). The agreement calls for each company's share of taxes to be calculated separately and settled with the Parent 45 days after the filing of the tax return. This agreement was approved by the CDI on October 29, 2002.



Investment Advisory Agreement: Effective October 15, 2003, the Company and its affiliates entered into an agreement with AIG Global Investment Corporation (AIGGIC), a corporation organized under the laws of New Jersey to provide investment management services to the Company and its affiliates. The agreement was approved by the CDI on October 8, 2003. AIGGIC receives an advisory fee which is based on the .065% per annum of the market value, including cash and accrued interest, of the Company's portfolio assets under management. Investment management and accounting expense were \$7,000 and \$7,000 in 2005 and 2004, respectively.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to write property and casualty lines of business in 25 states and the District of Columbia. The following is a listing of the states in which the Company is licensed:

Alaska	Michigan	South Carolina
Arkansas	Missouri	South Dakota
California	Nebraska	Texas
Colorado	Nevada	Utah
Delaware	North Dakota	Vermont
Georgia	Ohio	Washington
Illinois	Oklahoma	Wisconsin
Indiana	Oregon	
Kentucky	Pennsylvania	

In 2006, the Company became licensed in the following states: Alabama, Iowa, Maine, New Jersey and Tennessee.

In 2005, the Company wrote \$23.5 million of direct premiums all of which were in California. The Company directly markets and underwrites private passenger automobile liability and physical damage. The Company cedes 100% of its premiums to its affiliate 21st Century Insurance Company, under the terms of a 100% quota-share reinsurance agreement.

## REINSURANCE

### Assumed

The Company does not assume any reinsurance.

### Ceded

On June 30, 1994, the Company entered into a 100% quota-share reinsurance agreement with its affiliate, 21st Century Insurance Company (21st), with a loss portfolio transfer of all existing policy liabilities and 100% cession of all new and renewal policies. All premiums, losses and underwriting expenses are ceded to 21st under this agreement.

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2005:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Maximum Limits
Auto Physical Damage Catastrophe (CAT) Excess of Loss	Transatlantic Re-insurance Co. (20%) Folksamerica Re-insurance Co. (20%) National Union Fire I.C. of Pittsburgh (60%)	\$20 million each loss occurrence	100% of \$45 million excess of retention each and every loss occurrence
Personal Excess Liability Policy (PELP) 90% Quota Share	Swiss Reinsurance America Corp. (55%) Hannover Ruckversicherungs AG (35%)	10% each loss occurrence	\$5million per underlying policy

A review of the Company's reinsurance agreements currently in force disclosed that they do not comply with Statements of Statutory Accounting Principles (SSAP) No. 62, paragraph 7, which states that "Reinsurance contracts shall not permit entry of an order of rehabilitation or liquidation to constitute an anticipating breach by the reporting entity, nor grounds for retroactive revocation or retroactive cancellation of any contracts of the requiring entity." The agreements include a special termination provision that conditionally allows either party to the treaty to terminate upon 45-days

notice in the event of insolvency or specified regulatory actions. It is recommended that the Company ensure that all future treaties entered into conform to SSAP No. 62, paragraph 7. The Personal Excess Liability Policy (PELP) quota share treaties' are of unlimited duration. It is also recommended that the Company amend the active PELP treaties to conform to SSAP No. 62, paragraph 7.

### FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2002 through December 31, 2005

Statement of Financial Condition  
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$ 8,308,864	\$ 8,308,864
Cash, cash equivalents and short-term investments	2,677,849	2,677,849
Investment income due and accrued	<u>140,181</u>	<u>140,181</u>
Total assets	<u>\$ 11,126,894</u>	<u>\$ 11,126,894</u>
<u>Liabilities, Surplus and Other Funds</u>		
Payable to parent, subsidiaries and affiliates		<u>663,623</u>
Total liabilities		663,623
Common capital stock	\$ 3,300,000	
Gross paid-in and contributed surplus	79,940,622	
Unassigned funds (surplus)	<u>(72,777,351)</u>	
Surplus as regards policyholders		<u>10,463,271</u>
Total liabilities, surplus and other funds		<u>\$ 11,126,894</u>

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses incurred	\$ 0	
Loss expense incurred	0	
Other underwriting expenses incurred	<u>0</u>	
Total underwriting deductions		<u>0</u>
Net underwriting gain		0

Investment Income

Net investment income earned	\$ 524,514	
Net realized capital gains	<u>11,021</u>	
Net investment gain		<u>535,535</u>
Net income before all federal and foreign income taxes		535,535
Federal and foreign income taxes incurred		<u>183,581</u>
Net income		<u>\$ 351,954</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$ 10,111,317
Net income	<u>351,954</u>	
Change in surplus as regards policyholders		<u>351,954</u>
Surplus as regards policyholders, December 31, 2005		<u><u>\$ 10,463,271</u></u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2002 through December 31, 2005

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 9,392,572
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 1,071,101	\$	
Aggregate write-ins for losses in surplus	<u>                    </u>	<u>402</u>	
Totals	<u>\$ 1,071,101</u>	<u>\$ 402</u>	
Net increase in surplus as regards policyholders for the examination			<u>1,070,699</u>
Surplus as regards policyholders, December 31, 2005, per Examination			<u>\$ 10,463,271</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

None

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Reinsurance - Ceded (Page 8): It is recommended that the Company ensure that all future treaties entered into conform to Statements of Statutory Accounting Principles (SSAP) No.62, paragraph 7 and also amend its active Personal Excess Liability Policy treaties to conform to SSAP No.62, paragraph 7.

### Previous Report of Examination

None

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Laura Clements, CFE  
Examiner-In-Charge  
Senior Insurance Examiner (Supervisor)  
Department of Insurance  
State of California